DEPARTMENT OF STATE REVENUE

02-20080583.LOF

Letter of Findings: 08-0583
Indiana Corporate Income Tax
For the Years 2004, 2005, and 2006

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ISSUE

I. Apportionment – Corporate Income Tax.

Authority: IC § 6-3-2-2; IC § 6-3-2-2(e); 6-3-2-2(n); IC § 6-8.1-5-1(c); IC § 6-3-2-2(b); 45 IAC 3.1-1-37; 45 IAC 3.1-1-38; 45 IAC 3.1-1-47; 45 IAC 3.1-1-48; 45 IAC 3.1-1-53.

Taxpayer challenges the Department of Revenue's disallowing apportionment of taxpayer's income.

STATEMENT OF FACTS

Taxpayer is an Indiana manufacturer of medical supplies and equipment. Taxpayer sells its products through the United States through independent distributors and its own sales persons.

The Indiana Department of Revenue (Department) conducted an audit review of taxpayer's business records and tax returns. The audit resulted in various adjustments and a consequent assessment of additional tax. Taxpayer disagreed with certain of the audit's conclusions and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Apportionment – Corporate Income Tax.

DISCUSSION

The Department's audit concluded that taxpayer was not entitled to apportion its income on the ground that "taxpayer does not establish NEXUS in any other state except Indiana." As a basis for that conclusion, the audit report states that taxpayer's manufacturing plants and headquarters are located in Indiana, that taxpayer has no office or other place of business in any other state, and that taxpayer does not maintain inventory, merchandise, or property in any state other than Indiana. In addition, the audit report noted that taxpayer does not distribute its merchandise to out-of-state customers by means of taxpayer's own vehicles; instead taxpayer's sales force – which operates out of their homes and use their own vehicles – merely solicit orders, the orders are forwarded to taxpayer's Indiana offices, and the goods shipped to the out-of-state customers. Further, the audit report indicates that "taxpayer does not render services to customers in any other state."

The issue is whether or not taxpayer's total income should be apportioned pursuant to the provisions found at IC § 6-3-2-2(b) which provides as follows:

> Except as provided in subsection (l), if business income of a corporation or a nonresident person is derived from sources within the state of Indiana and from sources without the state of Indiana, the business income derived from sources within this state shall be determined by multiplying the business income derived from sources both within and without the state of Indiana.

45 IAC 3.1-1-37 sets out the standard for determining when a taxpayer's income is apportioned. The regulation states in part that, "Corporations doing business both within and without Indiana shall determine their income from Indiana sources through the use of the allocation and apportionment provisions contained in IC § 6-3-2-2(b)-(n) which generally follow the Uniform Division of Income For Tax Purposes Act."

45 IAC 3.1-1-38 states that:

> For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such state including, but not limited to:
>
> (1) Maintenance of an office or other place of business in the state
> (2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
> (3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution
> (4) Rendering services to customers in the state
> (5) Ownership, rental or operation of a business or of property (real or personal) in the state
> (6) Acceptance of orders in the state
> (7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L.86-272 to tax its net income.

Taxpayer argues that it is "doing business" in other states because its activities in those states exceeds the "mere solicitation of orders." Taxpayer concludes that because it is "doing business" in other states, its income should be apportioned pursuant to IC § 6-3-2-2(b).

As a threshold issue, it is the taxpayer's responsibility to establish that the existing sales tax assessment is

incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

A. Payroll Apportionment:

Taxpayer has met its burden of demonstrating that for apportionment purposes, taxpayer's activities in Texas, Pennsylvania, and Missouri exceed the mere solicitation of orders so as to give those states nexus under P.L. 86-272 (15 U.S.C.S. § 381) and permit those states to tax its net income. Taxpayer has documented that it files for and pays a net income tax in those states. Therefore, taxpayer is entitled to apportion its income. Further, taxpayer's payroll is to be apportioned among all states in which it conducts business even if it is not necessarily subject to a net income tax in each particular state. 45 IAC 3.1-1-47, 48.

B. Sales Apportionment:

Taxpayer protests the attribution of sales made to locations in other states. The Department treated these sales as "throwback" sales attributed to Indiana. IC § 6-3-2-2(e); 6-3-2-2(n).

The audit determined that, for purposes of calculating taxpayer's Indiana tax liability, the receipts from sales to out-of-state customers should be thrown back to Indiana because the sales were made within jurisdictions where the taxpayer was not subject to a state income tax. The audit based its decision on 45 IAC 3.1-1-53 (Example 5) which states that "[i]f the taxpayer is not taxable in the state of the purchaser, the sale is attributed to [Indiana] if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state." Such sales are designated as "throw-back" sales. Id.

The basic rule is found at IC § 6-3-2-2. IC § 6-3-2-2(e) provides that "[s]ales of tangible personal property are in this state if... (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and... (B) the taxpayer is not taxable in the state of the purchaser." IC § 6-3-2-2(n) provides that "[f] or purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if: (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not." Therefore, in order to properly attribute income to a foreign state, taxpayer must show that one of the taxes listed in IC § 6-3-2-2(n)(1) has been levied against him or that the state has the jurisdiction to impose a net income tax regardless of "whether, in fact, the state does or does not." Id.

Because taxpayer has established that in Texas, Pennsylvania, Missouri, Ohio, New Jersey, and North Carolina it is subject to "a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax," sales to customers in those six states should not be thrown back to Indiana.

FINDING

Taxpayer's protest is denied in part and sustained in part. Taxpayer's payroll should be apportioned among the states in which taxpayer conducts business; taxpayer's sales to Texas, Pennsylvania, Missouri, Ohio, New Jersey, and North Carolina should not be "thrown back" to Indiana.

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